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Economy

White House Unveils Plan to Overhaul Credit Rules

by Jim Zarroli

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[All Things Considered](#), March 13, 2008 · The Bush administration explained Thursday how it would like to overhaul Washington's vast regulatory system to prevent another crisis in the nation's credit markets. It said banks, mortgage companies, investors and credit-rating agencies all share in the blame for creating the crisis.

It also proposed that mortgage brokers be licensed and added some new voluntary guidelines to address the problem.

The report was prepared by the president's working group on the financial markets, which includes all of the major regulatory agencies.

Treasury Secretary Henry Paulson said a big surge in mortgage delinquencies — and the spread of enormously complex new debt products — has hurt the markets, and has exacerbated and uncovered other weaknesses in the system. Paulson said the group wants to find ways to contain the problem — without going too far.

"The objective here is to get the balance right. Regulation needs to catch up with innovation and help restore investor confidence but not go so far as to create new problems," he said.

The group proposed new licensing standards for mortgage brokers. It also said mortgage lenders need to be required to spell out for borrowers exactly how much their mortgages will cost over time. That way, fewer homeowners will find themselves saddled with monthly payments that suddenly adjust to levels they didn't expect and can't afford.

"This is a very good ... late attempt at trying to fix the problems. ... They're doing a lot to return some confidence to the market," said Anthony Sanders, a professor of finance at Arizona State University.

But Joseph Mason, associate professor of finance at Drexel University, was more critical about the report, saying, "It doesn't go far enough and is too vague to be of any help."

For instance, the report said some effort needs to be made to ensure that banks do a better job of assessing risks. That way, companies like Citigroup will be less likely to become immersed in bad mortgage debt the way they are now.

And the report said the credit-rating agencies that decide whether these risky securities are safe to buy need to be much more transparent about the way they work.

But the report seemed to suggest that this be done voluntarily and not be legislated by Congress.

"They fall back on 'Well, if they make disclosures clearer somehow that's going to help people' and in fact this system is so broken that we need much stronger laws," said Ira Rheingold, who heads the National Association of Consumer

Advocates.

Rheingold said it's frustrating that the Bush administration took so long to acknowledge the mortgage crisis. But Rheingold also said the administration was gradually becoming less doctrinaire about its free-market principles.

"The fact that they're offering proposals, that says that the government actually has a role here and that the government needs to step in and regulate a marketplace that has failed is a big move for this administration," he said.

Just as the report was coming out Thursday, there was another vivid illustration of how much damage the mortgage crisis is doing: The big U.S. buyout firm the Carlyle Group said one of its affiliated investment funds had defaulted on more than \$16 billion in debt. The fund had suffered huge losses in the subprime mortgage fiasco, and efforts to renegotiate its debts had failed. The announcement of the default sent stocks tumbling, although they recovered later in the day.

Economy

What the U.S. Can Learn from Japan's 'Lost Decade'

by Eric Weiner

Japanese Lessons

Nearly two decades before America's mortgage crisis, Japan weathered a real estate crisis of its own. Economists who have studied both countries say Japan's experience offers important lessons:

Don't Procrastinate. Japan's central bank was slow to intervene, ignoring warning signs that some Japanese banks were in serious peril. By contrast, the U.S. Federal Reserve has twice cut short-term interest rates sharply — and may do so again.

Don't Try to Spend Your Way Out of a Crisis. Japan ramped up spending on public works projects. It didn't ease the financial crunch, and left the Japanese countryside riddled with concrete.

Save, Save, Save. Japan's economic fall

Imagine this scenario: Real estate prices plummet, banks falter and policymakers wring their hands while a nervous public watches and worries. America in 2008? No. Japan in 1990.

Nearly two decades before America's mortgage crisis, Japan weathered a real estate crisis of its own. And Japan's experience — while far from a carbon copy of America's — offers important lessons for the U.S., say economists who have studied both countries.

In some ways, the similarities are striking. Both housing bubbles involved reckless lending and high-flying real estate — commercial in Japan, residential in the U.S. As in the U.S., Japan was flooded with cheap and easy credit, thanks to newfangled

financial products such as derivatives. Real estate prices soared. For a consumers have one of the highest savings rates in the world. That allowed them to maintain virtually the same rates of consumption throughout the 1990s. American consumers have no such savings to draw upon.

Be Transparent. In Japan, it took years before the government stepped in and forced banks to come clean about bad loans. That prolonged the crisis, since nobody knew where the bottom was. In the U.S., where the financial system is generally more transparent, banks have already swallowed large write-offs for losses on subprime mortgage deals.

while, the tiny spit of land surrounding the Imperial Palace in central Tokyo was worth more than the entire state of California, and a \$1,000 bill (if such a thing existed) would not pay for the surface area it would cover in the city's Ginza district.

Japanese investors believed they had broken free of the usual boom-and-bust cycles. Everyone assumed that prices would continue to climb indefinitely. "Even if some local property markets tanked, (Japanese investors) figured, a nationwide bust was almost unthinkable. They were very wrong," scolds *The Economist* magazine.

Sound familiar? Such exuberance was also common in the U.S. just a few years ago, when homebuyers, real estate agents and speculators breathlessly opined that "real estate prices never go down."

Japan's Biggest Victims

Of course, they do. In the mid-1990s, real estate in Japan lost nearly two-thirds of its value. The economic woes lingered for 10 years, prompting the Japanese media to pin an unhappy sobriquet on the 1990s: "the lost decade." The Japanese economy — and by extension, the country's national pride — has never fully recovered from that economic downturn. The main Japanese stock market is hovering near an 18-year low, and the country's manufacturers now face stiff competition from China. The U.S., too, faces increased competition from China, so the current economic stumbles come at a bad time, economists say.

Japanese banks were the biggest victims of the country's real estate bust. They were in danger of insolvency, yet Japan's central bank was

slow to intervene. Eventually, in 1995, the Bank of Japan began to cut interest rates, and today they are near zero percent. But by then the economic damage already had been done.

Among the Bank of Japan's critics was a prominent Princeton University economist, who blamed "exceptionally poor monetary policymaking" for the country's protracted malaise. The central bank's failure to lower interest rates in the early 1990s ultimately drove the economy into a deflationary death spiral, according to the Princeton academic.

That economist was Ben Bernanke, now chairman of the U.S. Federal Reserve. Bernanke has clearly taken the lessons of Japan to heart. The Fed has twice cut short-term interest rates sharply, lowering its benchmark rate to 3 percent, and suggesting that it is prepared to lower rates yet again. In addition, the Bush administration hopes the government's economic stimulus package — including tax rebates for families and tax breaks for businesses — will help boost the faltering economy.

Advantages for the U.S.

That quick action on the part of the Federal Reserve is one reason why many economists believe the U.S. is better positioned than Japan to weather a real estate crisis. The Japanese bubble burst at the end of the "miracle years" — a 30-year period when the economy headed in only one direction: up. When that trajectory finally reversed, "No one in Japan was willing to stand up and say 'We have a problem and action needs to be taken,'" says Daniel Alpert, a managing director at Westwood Capital, a New York investment bank. "In the U.S, we've been through enough financial cycles to understand that these things happen and they need to be corrected."

Another reason the U.S. is better positioned to weather the economic storm is that the storm in the U.S. is less severe than the one Japan faced. Even during the go-go years of the recent real estate boom, prices never approached those in Japan. (U.S. housing prices nationwide have declined about 10 percent from their peak, and most economists expect a further decline of 10 to 15 percent, though some parts of the country — namely California and Florida — are experiencing steeper declines.)

And Japan's corporations were far more dependent on commercial banks for financing than are today's U.S. multinationals, which have stockpiles of internal capital, as well as broader access to capital markets.

What's more, the U.S. financial system is generally more transparent than that in Japan. The country's industrial groups, or *keiretsu*, are chummy clubs, and banks were willing to quietly bail out a troubled firm with "no questions asked" loans. It was not until the late 1990s that the Japanese government stepped in and began forcing banks to come clean about bad loans.

By contrast, U.S. banks have already swallowed large write-offs for losses on subprime mortgage deals. And while the full extent of the mortgage meltdown remains to be seen, the U.S. is much closer to achieving what economists call "price discovery" — determining the true value of inflated real estate. Once that happens, the markets recover fairly quickly, according to Daniel Alpert.

If there is one lesson the U.S. should learn from Japan, he says, it's this: "Don't allow the situation to fester. Take immediate action."

More Spending Is Not the Answer

Another lesson from Japan: Don't try to spend your way out of an economic trough. Japan ramped up government spending on public works projects, including bridges and river "improvement" programs that literally lined many waterways with cement. But it didn't work, and today the only evidence of this spending binge is the ugly slabs of cement that mar the Japanese countryside.

In other ways, though, the U.S. is more vulnerable than Japan was in the 1990s. Japan has one of the highest savings rates in the world; the U.S. among the lowest. Japanese consumers, flush with savings, maintained virtually the same rates of consumption throughout the 1990s. American consumers have no such savings to draw upon — and, in fact, carry heavy debt loads — including debt accrued through home equity loans.

"It is the debt load of consumers in the U.S. that makes U.S. problems much worse than what happened in Japan," argues blogger Mike Shedlock in globaleconomicanalysis.com.

As many analysts have pointed out, millions of American homeowners used their houses as ATMs. That ATM, however, is now out of service and probably won't be open for business again anytime soon.

Eric Weiner was NPR's Tokyo correspondent from 1999 to 2003.

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